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THE TENGLER REPORT
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Commentary by:
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Mr. Magoo's Washington

If I were pressed to come up with a suitable analogy for DC and the bureaucrats who dwell there, it wouldn't be "Top Gun" or even "Mr. Smith Goes to Washington," rather, it would be Mr. Magoo of 1950's cartoon fame.

As near-sighted J. Quincy Magoo walks blithely along, his inability to see clearly masks the destruction occurring all around him. Washington and Magoo have one other trait in common: a stubborn refusal to admit the problem. In Washington's case, the chaos often committed by their actions—and make no mistake, those poor policies straddle both parties—goes unrecognized, un-examined, unresolved, doomed to be repeated. Sadly, republicans and democrats are equal opportunity offenders.

Cue the cartoon chorus: "Oh Magoo, you've done it again!"

The antitrust drumbeat has begun in Washington. Large corporations and their uncompetitive policies must be curtailed, we are told. I've been around long enough to have seen this particular movie before, and it rarely produces the intended result.

The break-up of AT&T due to an antitrust lawsuit resulted in the launch of the Baby Bells in the early 1980s. AT&T subsequently faced competition in the long-distance market while the Baby Bells held an iron grip on local service. Ten years later, the Baby Bells began to consolidate to rationalize employees, technology, and costs—the stronger acquiring the weaker—until now, some 30-40 years later, we are down to just a few providers of telecommunications services, and none of the regulatory actions seem to have mattered one whit.

Excessive regulation inevitably results in industry consolidation. The most recent example in the real-time Washington lab is health care. After ObamaCare limited insurer profits, Aetna and Cigna merged with more profitable pharmacy benefit managers, and the Kaiser Family Foundation reports that "primary-care-practice market concentration in metropolitan areas increased 29% between 2010-2016." To comply with increased government oversight requires deeper pockets—bigger government begets bigger companies.

Health care is merely one example. Dodd-Frank sparked consolidation in the banking industry. Railroads in the 20th century provide another dreary example. When Washington intervenes, unintended consequences abound.

Regarding the question of climate change and central banks: Christine Lagarde, European Central Bank (ECB) president, recently commented on climate change from the ECB perspective, "We are not driving the bus, if you will, but we are on the bus and we have to look at whether, under our mandate, it has an impact on price stability." Huh? Lagarde went on to admit she wasn't sure if the green transition would push inflation up or down. That should make us all nervous. We are seeing the same trends at the Fed. Yet nowhere in the Fed's mandate do we find a reference to managing climate change. These times they are a changing.

Oil: I applaud clean energy. Like all Americans, I like clean air and clean water, and we are actively investing in clean energy solutions at Laffer Tengler Investments. But we would be naïve to think the transition will be immediate. Fossil fuels provide a needed bridge to better solutions.

Consider the following from an article in *Wired* at the end of last year (11/30/2020) authored by Daniel Oberhaus and entitled: "The Race to Crack Battery Recycling—Before It's Too Late," "A common pyro method, called smelting, uses a furnace powered with fossil fuels, which isn't great for the environment, and it loses a lot of aluminum and lithium in the process." Elsewhere, I read that the furnace must be heated to approximately 1700 degrees Fahrenheit to recycle a lithium battery but have been searching for the article (to cite) to no avail. All I can find is a reference to the need to heat the battery. Either way, the fact is, it takes a great deal of energy to recycle a lithium battery. Solar and wind are unlikely to do the trick—as I said, oil is the bridge.

Oil permeates every aspect of our lives. Following are a sampling of items made with petroleum products. But check out the link here—the list is eye-opening: trash bags, computers, lipstick and hand lotion, perfume, hair dye, mascara, eyeshadow, clothing, nylon rope, candles, detergent, housepaint, eyeglasses, tennis rackets, also tires, asphalt, propane…well you get the idea. Oh, and my beloved kayak is on the list. I think about its oil origin every time I launch it into the pristine waters of Lake Tahoe.

The U.S. is likely to remain oil dependent for years to come—many experts believe the bridge to green energy will continue well into the next decade. Halting leases in the Arctic National Wildlife Refuge (ANWR), denying new permits in ANWR, ceasing the construction of the Keystone pipeline, and putting pressure on banks who lend to the industry have reduced supply while demand has increased. (In California I recently saw gas at $5.69 a gallon. Nationwide gas prices are up approximately 45% year-to-date). The U.S. went from energy independent to energy dependent in a matter of months.

Oh, DC you've done it again.

Inflation is likely to be stickier than the Fed expects. Much as the state of Israel has historically required mandatory service for young adults, I believe Washington bureaucrats should be required to spend a minimum of one month outside the Beltway. They could learn a great deal. Many years ago, I was asked to interview for Federal Reserve Board Governor. You can stop laughing now. (No one found it more humorous than I did, but how could I pass up the opportunity to attend the interview?)

Most striking was a statement made by the high-level cabinet official who interviewed me. He declared, "Look at what we've done for consumers by keeping interest rates low."

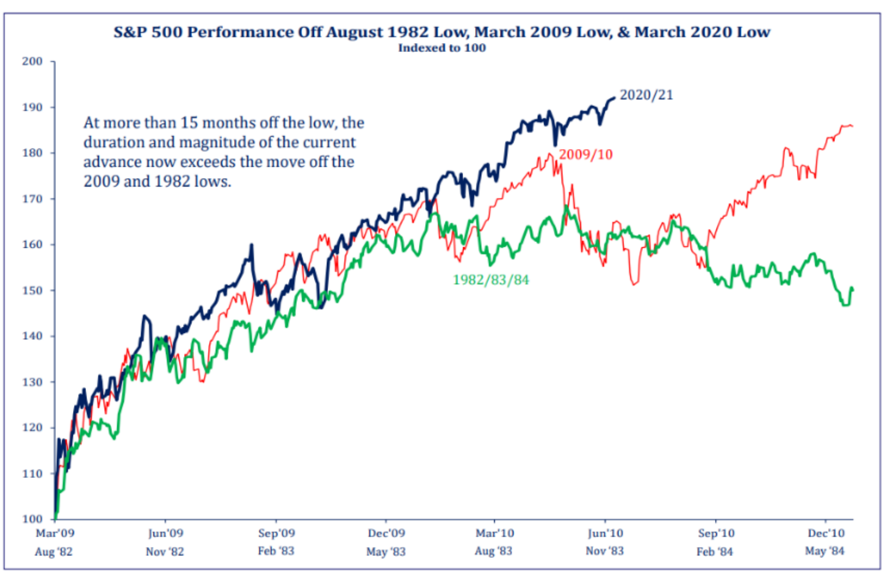
I countered, "But what about all those individuals who retired with certain interest rate expectations who can't pay the bills? They are now spending retirement working to supplement their income." He looked at me like I was from outer space… or, more precisely, outer Beltway.

Fast forward, I recently met with a smart and savvy client who owns a manufacturing business in the Midwest. He is a manufacturer who has seen his input prices rise. So, in January he hiked prices 2%, another 7% in March, and 8% in July. No pushback from clients. To attract entry level employees, he raised wages 10-12%, depending on the nature of the job. Yes, improving productivity is a focus, but as he said to me: those wage increases will not reverse. And to the extent he can, he intends to keep the price hikes in place. He thinks he will be able to.

Transitory inflation is a theory. I hope it is a valid theory. July 13th, we witnessed a Consumer Price Index (CPI) print of 5.4%—well above expectations of 4.9%, and well above the previous month's post of 3.8% (which, it should be noted, came in much higher than the Fed expected). Today, July 14th, the Producer Price Index (PPI) numbers came in scorching hot and well ahead of expectations. Year over year, PPI is up 7.3%. The Fed may be too sanguine about the inflation fighting tools they have at the ready. As I have written previously, every fire fighter understands that a controlled burn can turn into a wildfire, just like that.

Where does the market go from here? Interestingly, since yields peaked on March 31st of this year, growth has dramatically outperformed value, and copper has returned 7.2%, though recent trends have been weak. (The green energy narrative supports copper prices and supply is woefully behind the curve—we expect chop as the rest of the world slows but think the long-term trend in copper prices is higher.)

Historically, a strong first-half generally is bullish for the second half of the year. This rally has been stronger off the lows than 1982 and 2009-2010. See the chart below. Given the reasons for the 2020 bear market (a pandemic) and the rapidity of the economic bounce (the reopening), it is difficult to compare to the periods mentioned. But this chart from Chris Verrone at Strategas provides a fabulous visual.



Source: Strategas, July 1, 2021

We have been expecting a correction for months though we remain long. The market, instead, has been correcting by sector and style. That may be all we get with the retail marginal dollar adding support to stock prices and company buyback announcements now higher than pre-pandemic announcements. Both have been providing a floor for stocks. That is likely to continue.

We are watching inflation. We are watching Mr. Magoo's Washington, and we are laser-focused on 2Q earnings.

More soon.

Nancy Tengler's Recent USA Today Articles
Companies Are Playing Down Price Hikes, Smart Investors Need to Embrace Them. (June 22)

Nancy Tengler's Recent Media Appearances
Kudlow: Is Biden Putting America's Fate in Foreign Hands, Again? (Fox News, July 13)
Nancy Tengler Talks About the Importance of Growth Picks (AmeriTrade Network, June 25)

THE LAFFER TENGLER INVESTMENTS DISCIPLINE

Discipline is key to sustainable long-term total returns:

- At Laffer Tengler Investments we use two, time-proven stock valuation metrics (both pioneered by our team) that are consistent and robust indicators of value: Relative Dividend Yield (RDY) and Relative-Price-to-Sales Ratio (RPSR).

- Why not use earnings like almost everyone else? Because earnings are often an unreliable indicator of value. In May of 2016, I published the following:

Earnings reported by corporations have always been subject to the vagaries of accounting gimmickry. You don't have to be a novice to scratch your head at the way managements (or governments for that matter!) account for various items.

A recent case in point: The Wall Street Journal (Thursday, February 25, 2016) reported that according to FactSet, pro forma earnings for S&P 500 companies rose 0.4% in 2015. Using generally accepted accounting principles or GAAP, earnings per share actually fell 12.7% in 2015 (this according to S&P Dow Jones Indices). The author's point is that according to GAAP earnings, investors are paying a great deal more for stocks than they think. The price-to-earnings ratio (P/E) on pro forma earnings (which is the most commonly accepted method) is 17x 2015 earnings. But when GAAP earnings are considered, the P/E jumps to more than 21x.

It is important to remember that the P/E ratio for any given stock is only as good as the price input (a fact) and the reported earnings input (apparently not a fact at all).

- **RDY** measures the yield of a particular stock compared to the yield on the S&P 500 and does so over long periods of time. Since a stock's relative yield and relative price are inverse, we can generally conclude that as a stock's yield is rising, its price is declining—similar to a bond. Consequently, a rising RDY provides an opportunity for investors to at least consider an underperforming, cheaply valued stock for purchase.

- Company managements and boards of directors pay the dividend out of free cash flow, not earnings. In maturing U.S. companies these seasoned professionals often operate within a "dividend paying culture" and set the dividend as a portion of long-term, sustainable real earnings power because management teams are loathed to cut dividends.

- The relative nature of the RDY metric is also important because it measures the relative attractiveness of a stock compared to its own history and compared to the S&P 500. (In 1992, I co-authored Relative Dividend Yield, Common Stock Investing for Income and Appreciation with Tony Spare)

- RPSR: In fallen-angel growth companies where the dividend is less of a factor in management's calculus, we look at sales—a fact. Rarely are sales manipulated and when they are someone usually goes to jail. The price-to-sales ratio measures how much investors are paying for a unit of sales, the relative price-to-sales ratio reveals what investors have historically paid for a particular company's sales compared to what they are paying for the sales of all the companies in the S&P 500. In 2003, I authored New Era Value Investing, John Wiley & Sons where I outline the benefits of RPSR in stock selection.

- Discipline, in summary, is the only way to navigate volatile markets. We remain disciplined and over time that consistency generates excess return.

Fundamental Research reduces the ownership of terminally cheap companies:
Meet the 12 Fundamental Factors.

Our proprietary research approach analyzes fundamental qualitative and quantitative factors.

- **Qualitative Factors:** Catalyst for Outperformance, Franchise Value & Market Growth, Top Management/Board of Directors.

- **Quantitative Factors**: Sales Growth, Operating Margins, Relative P/E, Positive Free Cash Flow, Dividend Coverage/Growth, Asset Turnover Ratio, Use of Cash (buyback, debt, div.), Leverage, Financial Risk.

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There is no assurance that a portfolio will achieve its investment objective.

Definitions and Indices

The S&P 500 Index is a stock market index based on the market capitalization of 500 leading companies publicly traded in the U.S. stock market, as determined by Standard & Poor's.
Unless otherwise noted, index returns reflect the reinvestment of income dividends and capital gains, if any, but do not reflect fees, brokerage commissions, or other expenses of investing. Investors cannot make direct investments into any index.

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